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CHAPTER 8

California's Public Sector Adapts to the Great Recession

DANIEL J.B. MITCHELL
University of California, Los Angeles

California, the most populous state in the United States, constitutes just under one eighth of the nation's population and a similar portion of its economic activity. In many respects, the state mirrors the adjustment of the public sector nationally in its regional response to the Great Recession. But California does deviate from the median state in a variety of ways apart from size. Its politics have been characterized (some would say dominated) by direct democracy: the initiative, referendum, and recall. And its unionization rate is somewhat higher than the national average, in large part due to higher public sector unionization.

While all state and local governments have experienced difficulties adapting their public sectors to the Great Recession and its resultant squeeze on tax revenue, California began the episode with an underlying structural deficit rooted two decades earlier. That shaky starting point complicated its adjustment. It did not help that California was very much the heartland of the housing and mortgage bubble whose collapse triggered the Great Recession. Thus, its labor market was more heavily affected than most other states. These themes are developed in this chapter.

Brief Political History

California attained statehood in 1850, but its economic linkage to the rest of the United States once the Gold Rush subsided was the Transcontinental Railroad, which was not completed until 1869. That crucial rail link evolved into the Southern Pacific Railroad during the latter part of the 19th century. Because of the railroad's near monopoly on trade and travel, its wealthy owners—the so-called Big 4—were perceived as squeezing state farms and businesses, dominating state politics, and corrupting the legislature.[1]

Progressives of the early 20th century, who were largely Republicans, rebelled against the influence of the railroad and saw direct democracy as the obvious counterweight to political corruption. In 1910, they succeeded in electing Hiram Johnson as governor. Johnson's administration the following year brought with it the initiative, referendum, and recall—along with women's suffrage and workers compensation insurance.

Progressivism in its early 20th century form continues to influence the state. As a doctrine it emphasizes an equation of good government with nonpartisanship. Since legislation—including constitutional amendments—can be enacted by voters, this substitute channel of authority weakens the role of the legislature and other elected officials. Even laws passed by the legislature and signed by the governor can be reversed through referenda. So-called ballot box budgeting can require spending by formula or obligation (in the case of bond authorizations), even when revenue is not provided, thereby leaving the legislature constrained in dealing with budget crises.

By some measures, California voters over the century since the advent of direct democracy have grown more progressive in a way that would be familiar to Hiram Johnson (i.e., constraining elected officials). They imposed tight term limits on members of the state legislature in 1990. As the 2010 U.S. Census loomed, they created an independent tribunal to draw legislative and congressional districts to prevent legislative gerrymandering.[2] Voters have expanded nonpartisan top-two primaries, in which candidates run as individuals in a single primary—not in primaries by party—and the general election consists of a runoff between the top two primary vote getters. Perhaps, more tellingly, the most rapidly growing political party among registered voters is no party. Although Democrats have a plurality in voter registration, more than a fifth of voters are not affiliated with Democrats, Republicans, or third parties. They are called "decline to state" voters, and their proportion of the electorate has steadily grown.

Some Underlying Economics

It is tempting to pin the blame for fiscal dysfunction in California on its direct democracy because these arrangements look different from those found in many other states. A lengthy section of the April 23, 2011, edition of *The Economist* magazine was devoted to just that premise. But there are reasons not to dwell entirely on direct democracy as *the* cause of the dysfunction. After all, in the years after World War II California was often looked to as a model for good governance, although it had direct democracy at the time. Its approach to freeway building pre-dated, and set the pattern for, the later federal interstate highway system.[3] It developed large and complex water supply systems. Its public schools were considered first rank. And at the higher education level, its 1960 Master Plan for Higher Education developed a framework for its community colleges, state colleges, and the University of California and presaged substantial expansion of all three systems.[4]

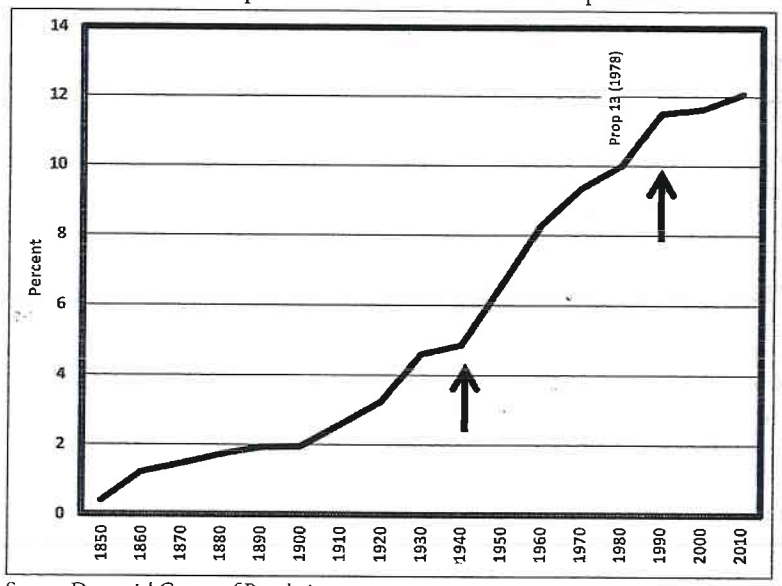
At the same time, California attracted an influx of people from other states (and later abroad) through growing job opportunities and affordable housing. Having Hollywood as a de facto public relations agent for the California lifestyle simply added to the attraction. In a sense, too much success and the consequent population in-migration led to an early glimmer of problems to come. In the late 1970s, a complicated stew of anti-growth sentiment and the economic impact of infill from an expanding population led to rising property values, which sparked a housing boom and commensurate jumps in property taxes. The result was the passage of Proposition 13 in 1978, an initiative that drastically cut and capped property taxes and led to the ongoing fiscal complications in California that are discussed in this chapter.[5]

It is noteworthy that Proposition 13 is often seen as sparking the national taxpayer revolt reflected in related developments in other states. Moreover, the taxpayer revolt tended to pull national politics rightward, notably with the election of Ronald Reagan (a former California governor) as president. The national uptake of a California phenomenon suggests that there is more to the California story than direct democracy. In recent years, California dysfunction has also been mirrored at the federal level. The same inability to enact budgets on time has been seen in Washington and Sacramento. Party polarization is a factor in both capitals. And there seems to be still another national–California connection with causation running from Washington to California.

As Figure 1 shows, there have been two major inflexion points in California history since statehood. As measured by population, California has a long history of growing faster than the rest of the United States. However, there is an upward tick in 1940, marking the expansion of federal military expenditures in the state during World War II, the Korean War, the Vietnam War, and the Cold War. The Cold War disappeared after 1990 with the end of the Soviet Union, and so did supernormal growth in California.

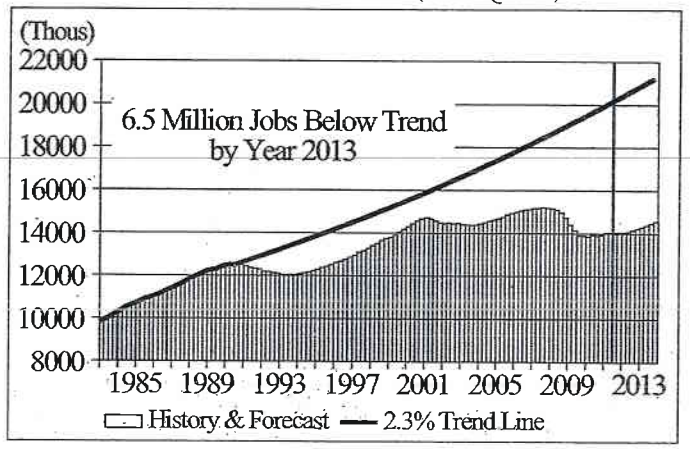
As Figure 2 shows, in employment terms, there has been a widening gap since 1990 between the old trend in jobs and the actual results in California. Even the California-centered dot-com boom of the late 1990s and the subsequent housing and mortgage boom of the mid-2000s did not prevent the gap between the old trend and the actual results from widening. The modern impression of California as a land of dysfunction thus has its roots in the 1990s. National attention in the 1990s often focused on visible symptoms such as the Los Angeles riots in 1992. The national obsession—once the dysfunction idea took hold—even included nonpolitical natural disasters such as the Northridge earthquake in 1994.[6]

FIGURE 1
California Population Relative to United States Population



Source: Decennial Census of Population.

FIGURE 2
California Nonfarm Employment History and Forecast
Versus 2.3% Trend from 1990 (Third Quarter)



Source: UCLA Anderson Forecast (2011), p. California-91.

In short, California's polity has had a great deal of difficulty recognizing and adjusting to the underlying end of military-fueled prosperity, even apart from the stresses imposed by the Great Recession. California's peculiar direct democracy institutions worked well enough when the state was growing rapidly. They became stressed when the engine of rapid growth was removed. Those familiar with earlier California history will not be surprised. During the Great Depression, there was also government dysfunction, in part operating through direct democracy and ballot propositions. But when the money rolled in starting with World War II, the dysfunction faded.

California's Public Sector

In 2010, state and local employees in California accounted for 15.5% of the state's nonfarm workforce. For the United States as a whole, state and local workers are about 15% of nonfarm employment. Thus, California appears to be about average by that measure. The unionization rate in the public sector in California in 2010 was high: 56.6% on a membership basis, 59.6% in terms of coverage. Comparable figures for the United States were 36.2% and 40%, respectively.[7] As Table 1 shows, the combination of high unionization in the public sector and declining unionization in the private sector means that more than half of union members in California are now in government positions. That shift helps

TABLE 1
California Union Membership Trend Unionization Rates

	Public sector union membership as a percentage of total membership	Unionization rates: Membership basis	
		Public	Private
Troy–Sheflin data			
1975	22.1%	35.8%	34.1%
1982	22.9	32.9	25.4
Hirsch–Macpherson data			
1983	27.7	43.4	17.7
1990	40.8	46.7	13.0
2000	48.5	50.3	10.7
2010	56.0	56.6	9.3

Note: Troy–Sheflin membership data are based on reports of labor organizations. Hirsch–Macpherson data are based on the Current Population Survey.
Source: Troy and Sheflin (1995). Hirsch–Macpherson data are from http://www.unionstats.com.

foster the idea of unions as a narrow special interest group representing just government workers at the expense of everyone else—and special interest labels are particularly anathema to California's progressive tradition.

State Regulation of Public Sector Collective Bargaining

California adopted a series of statutes regulating public sector collective bargaining using a model largely copied from the federal private sector regulatory framework.[8] Enactment of such statutes began in the early 1960s with a limited law covering local government. Major legislation followed in the 1970s, starting with a law for public schools. Similar statutes were later enacted for state workers other than university employees, with a separate statute applying to employees of the University of California and the California State University systems. In addition, there are specialized statutes for certain other groups. A state Public Employment Relations Board is the main administrative tribunal for much of the public sector. Although California law is silent on the right to strike of government workers, that silence has been judicially interpreted to mean that the right to strike exists in the public sector, with exceptions for certain public safety workers.

Data do not exist on small public sector strikes. However, the U.S. Bureau of Labor Statistics does keep track of major work stoppages involving 1,000 or more workers. There are at most a handful of such events in any given year in California, and they tend to be of short duration, often lasting only a day or so. At the peak of the business cycle in 2006, four stoppages occurred: three in various county governments and one in the City of Los Angeles. In 2007, there were only two: one in a school district and another in a transit district. The Great Recession seemed to repress such conflicts; there were no major California stoppages in either 2008 or 2009. With some degree of economic recovery under way, stoppages occurred in two school districts in 2010.[9]

At the state level, there were threats of job actions of various types up to and including strikes. The issue of furloughs was contentious but largely fought through litigation, with most decisions ultimately favoring the governor. At one point, there was a dispute over whether Columbus Day would remain a paid holiday, even though Governor Schwarzenegger had ordered state employees to work. Some individual workers indicated they would stay home on that day, but the issue seemed to peter out. Given the budgetary climate, union officials at the state level seemed to conclude that using the political route was the main practical path to influence.

Unions and State Politics

While unions played a role in state politics before the 1970s, the combination of general growth in the public sector and a widening public sector union presence was reflected in a major battle over a ballot initiative pushed by then-Governor Ronald Reagan. The initiative—Proposition 1 of 1973—would have capped state spending and a complicated formula would have ratcheted down the cap over time. It was seen at the time as a state version of similar approaches that conservatives were hoping to write into the federal constitution. Part of the opposition campaign focused on the complicated formula, which had been developed by academic economists and which the governor himself could not explain.[10]

Proposition 1 was defeated, only to be followed in 1979 by Proposition 4—the so-called Gann Limit spending cap—which was enacted in the anti-tax fervor after 1978's Proposition 13 (property taxes).[11] Public sector unions played important roles in the opposition to both Propositions 13 (in 1978) and 4 (in 1979) but evidently could not stem the popular tide of that era. However, when the Gann limit was reached in the late 1980s and produced tax rebates, teachers' unions and the broader educational establishment then successfully promoted Proposition 98 (and later Proposition 111), with formulas for state spending on K–14 education that effectively gutted the Gann limit.[12]

Table 2 uses contract data to show the key California unions in the public sector. The data, from a file maintained by the U.S. Department of Labor, refer to union contracts covering 1,000 or more workers.[13] It is apparent that in terms of union coverage, the dominant union is the Service Employees International Union (SEIU). Other important players are the unions representing teachers (especially the California Teachers Association), AFSCME, and the independent union representing prison guards (CCPOA). Some of the smaller unions are essentially local and may play significant roles in the politics of certain jurisdictions. Public sector unions have mainly been supporters of Democrats but, particularly in the case of the prison guards, can be pragmatic and may lend support to candidates of either party if they seem friendly to union positions.

It might be expected in a system of direct democracy that unions—as large membership organizations—would be at the forefront of using ballot propositions to further their goals. Initiatives, whether at the state or local level, require gathering signatures and then campaigning and voting drives. Large membership organizations would seem to have advantages in such efforts. However, with some notable exceptions such as Proposition 98

TABLE 2
Major California Public Sector Unions (Percentage of Workers)

Union	Percentage of Workers
Service Employees International Union	42.5%
California Teachers Association (NEA affiliation)	8.2%
American Federation of State, County and Municipal Employees	5.8%
United Teachers Los Angeles (CTA/NEA and AFT/CFT affiliation)	4.2%
California Federation of Teachers (AFT affiliation)	4.1%
California Correctional Peace Officers Association	3.7%
Communications Workers of America	2.9%
Coalition of University Employees	2.6%
Statewide Law Enforcement Association	2.0%
San Bernardino Public Employees Association	1.8%
International Union of Operating Engineers	1.7%
International Association of Fire Fighters	1.4%
Association for Los Angeles Deputy Sheriffs	1.3%
Professional Employees in California Government	1.3%
International Union of Police Associations	1.1%
Los Angeles Police Protective League	1.1%
Orange County Employees Association	1.0%
Amalgamated Transit Union	0.9%
Laborers International Union of North America	0.9%
California Association of Highway Patrolmen	0.8%
California Association of Psychiatric Technicians	0.8%
International Brotherhood of Electrical Workers	0.7%
Engineers and Architects Association (AFT affiliation)	0.6%
International Association of Machinists and Aerospace Workers	0.6%
Municipal Employees Association (San Diego)	0.6%
United Transportation Union	0.6%
All Others	6.8%

Source: U.S. Department of Labor major contract files available at http://www.dol.gov/olms/regs/compliance/cba/index.htm.

described previously, unions have not been enthusiastic users of direct democracy.[14] They have tended to operate in a defensive mode when propositions they do not like appear on a ballot—for example, defeating so-called paycheck protection initiatives in 1998 and 2005.[15]

In 2011, they persuaded Governor Jerry Brown to sign a law moving ballot propositions to the November 2012 general election and removing them from the presidential primary (which would be dominated by Republicans). Part of the motivation was to shift the odds against voter approval of a spending cap ballot proposition and a paycheck protection measure.[16] In effect, unions were using the legislative route to constrain direct democracy.

One result of union aversion to proactive direct democracy has been that the most enthusiastic supporters of the system of ballot propositions tend to be on the populist–right end of the political spectrum. Of course, both public and private unions have reasons to want to influence government action. But unions tend to focus on promoting and supporting candidates and on traditional lobbying. For example, various Hollywood unions successfully pushed for tax breaks at the state level to counteract similar breaks and subsidies for movie and TV producers offered in other states and countries. At the local level, unions have also pushed living wage ordinances for private providers to governments.[17]

Construction unions have particular interests in local development projects that are given public support through tax-increment financing and other devices. A state attempt to take some of the local funding by redevelopment agencies from property tax-increment financing and use it instead for the state's general-fund projects became a major battle in the 2011–2012 budget, as noted later in this chapter. Construction unions also seek to have local governments use project labor agreements, which indirectly favor union workers, when those governments fund infrastructure projects.[18] Obviously, public sector unions have a more direct interest in government spending programs that pay for the wages and benefits of their members. That interest comes into sharp focus when budget crises occur.

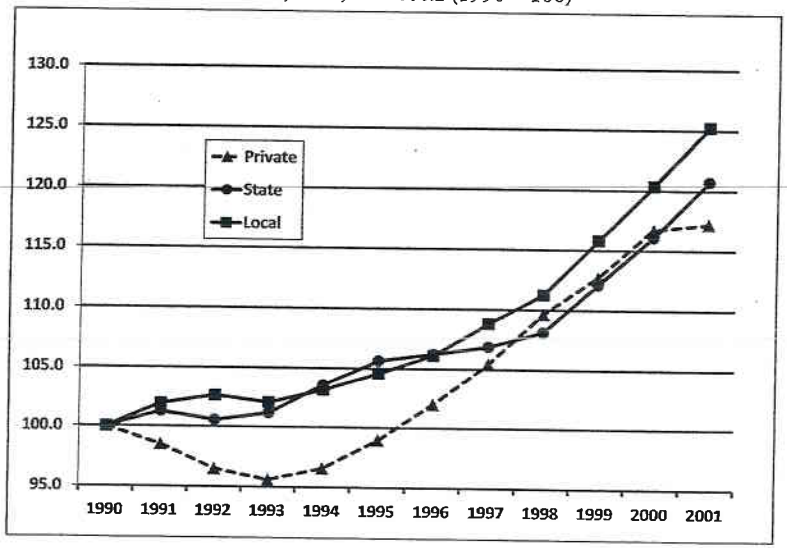
Unions, public and private, can be fractious. Hollywood unions, especially those representing above-the-line professionals (actors and writers), are known for internecine internal disputes and wide variations in the degree to which they cooperate with one another in negotiations. The SEIU, which has both public and private sector membership, has been distracted by a breakaway health care local. Purely public sector unions have their ups and downs in terms of influence. The CCPOA, which represents prison guards, was seen at one time as very influential in Sacramento. But expensive litigation with past union officials,

combined with the budgetary impact of the Great Recession and court decisions demanding a downsizing of the state prisoner population, put the CCPOA largely on the defensive. There is a sense that politics is local with regard to organized labor in California. National divisions, such as the split between the AFL-CIO and the Change to Win Federation, do not seem to have had much effect on local activity. At the state level, unions have worked together, or not, depending on their perceived interests and not on their affiliation.

Public Versus Private Employment Response to Economic Downturns

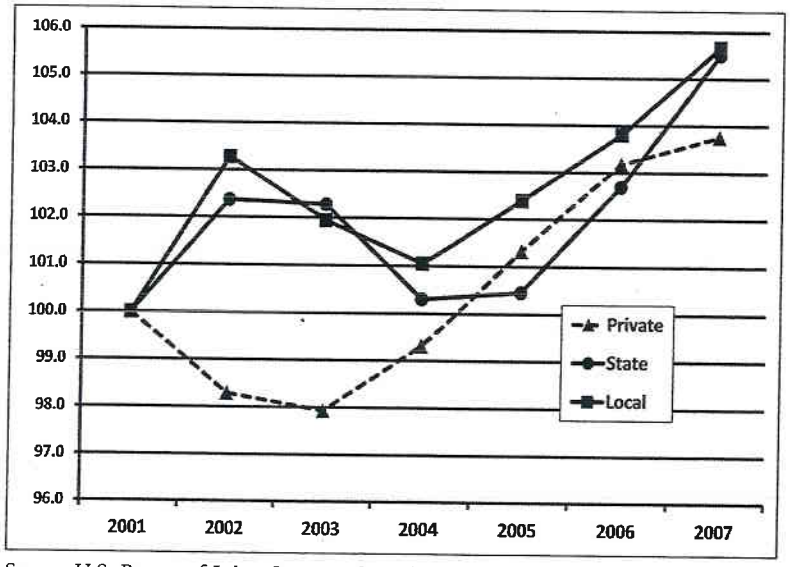
Although economic downturns reduce tax revenue, the public sector in California reacts with a lag to downturns compared to the private sector. Figures 3, 4, and 5 illustrate the response of private employment and public employment (state and local) to the recession of the early 1990s (end of Cold War), the dot-com bust, and the housing bust. Each chart is indexed so that the year containing the start of the downturn is set to 100 for nonfarm private employment, state employment, and local employment. In each case, private sector employment declines quickly, but there is a lag in the public sector response—and the percentage decline when it occurs is generally less than in private employment.

FIGURE 3
California Nonfarm Employment Trend 1990–2001:
Private, State, and Local (1990 = 100)



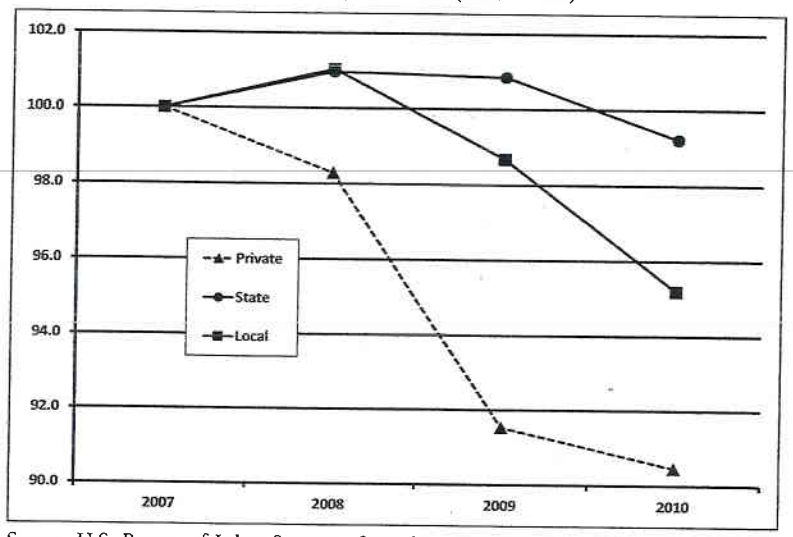
Source: U.S. Bureau of Labor Statistics. State data available at http://data.bls.gov/cgi-bin/surveymost?la.

FIGURE 4
California Nonfarm Employment Trend 2001–2007:
Private, State, and Local (2001 = 100)



Source: U.S. Bureau of Labor Statistics. State data available at http://data.bls.gov/cgi-bin/surveymost?la.

FIGURE 5
California Nonfarm Employment Trend 2007–2010:
Private, State, and Local (2007 = 100)



Source: U.S. Bureau of Labor Statistics. State data available at http://data.bls.gov/cgi-bin/surveymost?la.

The lag occurs because much of government production (services such as police, fire, and education) is not directly linked to the business cycle and in some areas (e.g., social services) demand for government production increases during periods of economic distress. In addition, government entities can run down past reserves to finance continued services and employment and, within limits, use debt finance. Finally, some funding for public employment at the state and local level comes from federal sources.

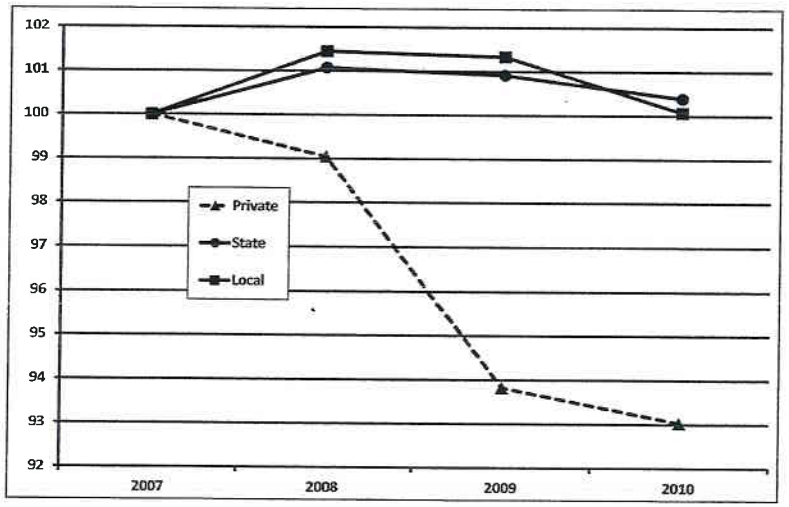
In the aftermath of the Great Recession, stimulus funding from the federal government helped delay and mitigate state and local job reductions in California until the money ran out. Federal money came with various strings attached. There were maintenance-of-effort requirements so that recipient governments would not simply shift regular expenses to support by the federal subsidy. The object of the stimulus program was to increase government activity beyond the baseline, not just support the baseline level. In the case of state-funded home care aides in California, federal rules—after litigation—blocked wage cuts the state attempted to impose.

California is not unique in exhibiting a public sector employment lag when the economy turns down. As Figure 6 indicates, during the Great Recession, California's public sector was arguably more responsive than the U.S. norm, perhaps because California was harder hit than most states. However, even that observation requires some qualification. As Figure 7 shows, at the peak of the housing boom, California's unemployment rates were low and in line with the national average across various state regions. The one exception was the state's Central Valley (represented by Fresno County on the chart), a rural area with a great deal of poverty and chronically high unemployment.

As the Great Recession took hold, unemployment rose in all regions, but the dispersion among regions increased. The Inland Empire region in Southern California had been a center of outlying housing construction, and with the housing and mortgage bust, its unemployment rate shot up.[19] The high-tech Silicon Valley was less affected than the rest of the state because its key industry is geared to the global economy much more than to local developments. As a result, the public versus private employment trend deviation played out differently in the two areas. In the Silicon Valley (Figure 8), private sector employment declined but by *less* than in the public sector. In the Inland Empire (Figure 9), the pattern was reversed.

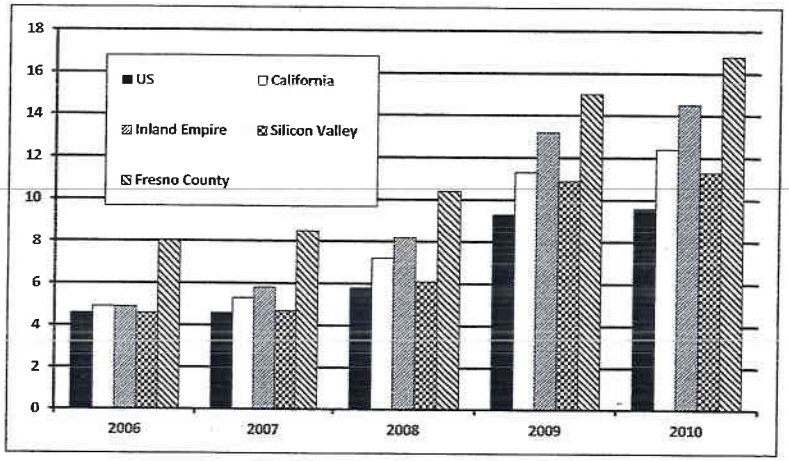
Part of the story behind this mirror-image effect is linked to California's fiscal arrangements. Especially after Proposition 13 drastically cut local

FIGURE 6
U.S. Nonfarm Employment Trend 2007–2010:
Private, State, and Local (2007 = 100)



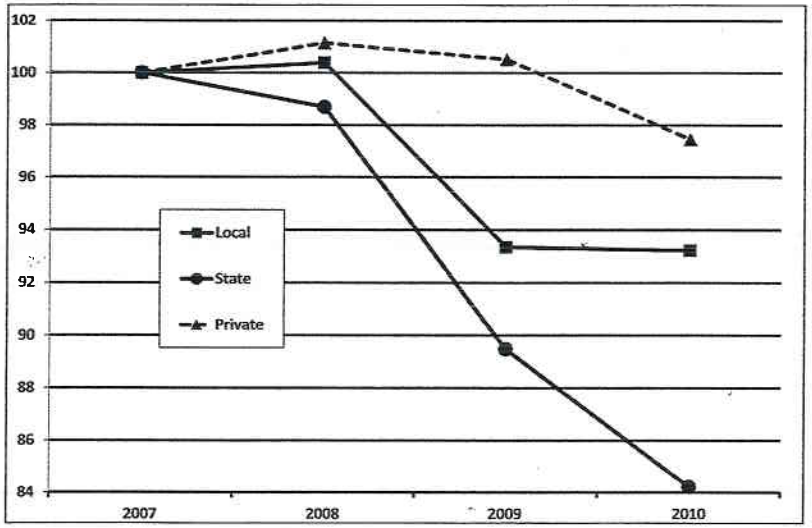
Source: U.S. Bureau of Labor Statistics. National data available at http://data.bls.gov/cgi-bin/surveymost?ce.

FIGURE 7
Unemployment Rates by Area: 2006–2010



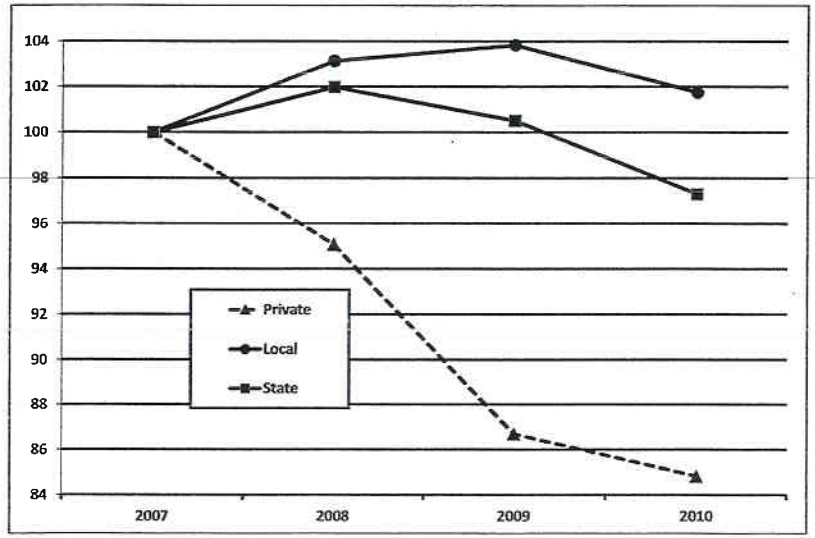
Source: California Employment Development Department. Local area data available at http://www.labormarketinfo.edd.ca.gov.

FIGURE 8
Silicon Valley Nonfarm Employment Trend 2007–2010:
Private, State, and Local (2007 = 100)



Source: California Employment Development Department. Local area data available at http://www.labormarketinfo.edd.ca.gov.

FIGURE 9
Inland Empire Nonfarm Employment Trend 2007–2010:
Private, State, and Local (2007 = 100)



Source: California Employment Development Department. Local area data available at http://www.labormarketinfo.edd.ca.gov.

property taxes, local governments, particularly school districts, became heavily dependent on state financing. Thus, whether a school district is in the affluent Silicon Valley or the depressed Inland Empire, its budget reflects the broader state budget and economy. State finance therefore can be, at least in relative terms, either a cushion against or an exaggerator of the business cycle; it tends to spread booms and busts in local areas statewide. For example, in the post–Cold War recession of the early 1990s, the declining aerospace industry was largely located in Southern California. But because the decline affected an important region of the larger state economy, school districts and other local jurisdictions in Northern California were affected by the general adverse impact on the state's overall budget.

Despite these regional variations, a general perception that the public sector is not doing its share can easily develop due to the public–private deviation in job trends. There can be political tensions and resentment as a result of the public–private contrast. Because of the overall relatively liberal–centrist political orientation of California, however, there was no overt Wisconsin-type political reaction in the state.[20] There were no serious proposals at the state level in California to end public sector collective bargaining, but there were moves in some conservative jurisdictions in that direction. Most notable was the affluent City of Costa Mesa in Southern California, whose city council went on an aggressive campaign of outsourcing and thereby stirred up an outsized controversy that attracted statewide and national interest.[21]

Retirement Benefits

In other jurisdictions and at the state level, there was a battle about government collective bargaining on the public pension issue, which served as a proxy for the larger issue of public unions and bargaining. Even in left-leaning San Francisco there were ballot initiatives and agitation about public pensions that extended to some prominent Democrats.[22] City of Los Angeles voters approved various constraints on police and fire pensions and retiree health care in March 2011.

At the state level, California has three major pension systems. CalPERS (California Public Employment Retirement System) is the largest of the three, with $236 billion in assets as of mid-2011. It covers state employees, except the University of California, plus employees of various localities that use its coverage. CalSTRS (California State Teachers Retirement System) has about $147 billion and covers schools. Finally, there is UCRP, the University of California Retirement Plan, with about $42 billion.

All three are significantly underfunded, and thus each poses long-run challenges to the state. However, it is not the case that there is a liberal–

conservative divide in terms of pension underfunding in California. The City of San Diego, a conservative Republican jurisdiction, became something of a poster child for poor pension management of its municipal plan even before the Great Recession. As the issue became apparent, it roiled San Diego politics. There were analogous developments in conservative Orange County, including a political battle over whether the county should be spending its money on litigation to undo past pension promises.

Accrued pension benefits in California are vested rights. However, the mix of employer and employee contributions and the level of those contributions are not fixed. Pension fixes at the state and local levels have generally involved increasing employee contributions and in some cases creating a lower tier of benefits for new hires. Public sector unions have been on the defensive with regard to retirement benefits because of the decline in the private sector of defined benefit (DB) plans, which are the norm in government. In the private sector, defined contribution (DC) plans have become the norm.

Defined benefit plans guarantee benefits by a formula typically based on years of service, age, and earnings history in the period prior to retirement. Retirees are thus shielded from the risk of the financial marketplace. The private sector now much more commonly uses DC plans, such as 401(k)s, which put the risk of investment performance on the employee. As in the case of employment trends, the public–private contrast in retirement programs has tended to put public sector unions in California on the defensive.

In terms of immediate budget impact, however, DB plans by their nature had only a minor role in state fiscal affairs. The large absolute amounts in the plans mean that remedies for underfunding can be deferred. For example, the plan for the University of California—even if there were no future contributions and the existing assets earned only a modest return—would likely be able to continue payouts for perhaps two decades.

To be sure, that approach (i.e., deliberate underfunding until the plan assets were dissipated) would not be good pension management policy or good fiscal policy. From the employee perspective, a fully funded pension trust fund is a guarantee that promises made will be kept. From a fiscal viewpoint, funding today's pension promises today is in keeping with the view that current expenses should not be charged to future taxpayers. But the fact that a defined benefit plan allows deferral of the funding of current promises illustrates that pension modifications can be deferred during budget crises. Some local jurisdictions, toying with the idea of switching

to defined contribution to improve their budget positions, seemed surprised by the discovery that the C in DC stood for "contribution." In a defined contribution world, by definition you have to make the contribution—it is not deferrable.

Apart from the structure of retirement benefits, it is bad economics to single out particular portions of an employee benefit package without looking at the entire package. There are many complicated elements in comparing the value of benefits, which will vary with the career history of individual employees. However, to the extent that standardization is possible, it appears that California public employees earn pay packages roughly comparable to those in the private sector once adjustments for individual characteristics are made. Even a study commissioned by a group pushing for pension cutbacks did not find major overall discrepancies.[23]

Average results, however, do not mean that particular groups are not out of line, either on the positive or negative side. There is considerable heterogeneity among California employees. Some are covered by Social Security, for example, while others are not. Generally, safety workers such as first responders have the most generous pensions—perhaps because of positive public attitudes toward police and firefighters. And even when total compensation is in line with the private sector, there can be underfunding. Employees are paid in part with retirement promises. Whether those promises are being properly funded is another matter.

Complicating the pension issue in California has been the question of governance. In some cases, there have been conflicts of interest and scandals regarding pension administrators and those seeking investment business from the funds, particularly at CalPERS. There have also been issues of large pension payouts to individuals where pension spiking or inappropriately high salaries have been paid. These instances—particularly a salary/pension scandal in the small Southern California city of Bell that left the city teetering on insolvency—received wide public attention in the news media. The result has been a miasma of pension problems—some administrative, some corrupt, some regarding adequate funding, and some regarding individual pension abuse.

The public does not necessarily segregate one pension issue from another. What results is an overall, but vague, impression of a pension problem. That is, at the level of the general public—as opposed to politicians and policy wonks—it is not clear that there is a deep sense of a pension problem, absent someone pushing the issue. When the California Field Poll questioned voters about their attitudes toward public pensions in 2009 and 2011, more respondents thought that public pension entitlements were either about right or not generous enough than thought them

excessive. Yet when the pollsters went on to suggest remedies such as pension reductions for a problem many respondents evidently thought did not exist, there was generally support for remedies. Presumably, if a pollster suggests a remedy, respondents suspect there must be a problem that requires a remedy.[24]

Table 3 summarizes data from the two Field pension polls. The polls in 2009 and 2011 were separated by the 2010 gubernatorial election in which the pension issue was highlighted as a problem. Thus, there was a shift in the direction of regarding public pensions as too generous. Even in 2011, as already noted, more respondents thought pensions were about right or not generous enough than thought them too generous. Yet in 2009—the year in which the poll response was more favorable to public pensions—when pollsters suggested a cap on pensions, majorities favored them (except for those voters who characterized themselves as liberal).

It may not be surprising that conservatives have less favorable attitudes than liberals about public pensions. But the age effect is interesting. Older voters are more likely than younger voters to view public pensions as too generous, a finding that suggests seniors who worked in the private sector are comparing their actual or impending retirement income with their perceptions of public pensions. It might be noted that the pollsters did not attempt to measure in any kind of dollar format what voters thought public pensions were. Similarly, issues of funding were not explored. A pension could be too generous and yet adequately funded. Or it could be too stingy but underfunded. It could be well managed or poorly managed. None of these distinctions were explored by the pollsters, and they also tend to be lost in public forums.

Governor Jerry Brown introduced a 12-point plan for public pensions (state and local) in late October 2011. Many of the details were not fleshed out. In broad terms, the proposal involved a two-tier approach, with new employees in a hybrid plan that would be part defined benefit and part defined contribution. As initially posed, parts of the Brown plan would require a vote of the electorate that could occur only if the legislature placed the plan on the ballot or the plan was put on the ballot via an initiative. The former route would require bipartisan support, and the latter would need $1 to $2 million for payments to signature-gathering firms to accomplish. Hence, the fate of the plan at this writing is unclear. Democrats in the legislature provided a cautious response. Republican responses ranged from "does not go far enough" to expressing encouragement. The largest state union, SEIU Local 1000, issued a statement that was intentionally noncommittal and nonconfrontational, indicating the governor should be thanked for providing "a good starting point."[25]

TABLE 3
California Field Poll on Registered Voter Attitudes Toward Public Pensions

	Too Generous*	Favor Cap**
All Respondents	32% [42%]***	59%
Male	40 [52]	60
Female	24 [34]	59
Political Viewpoint		
Strongly conservative	9 [55]	72
Moderately conservative	35 [56]	64
Middle of the road	31 [40]	62
Moderately liberal	20 [39]	47
Strongly liberal	14 [22]	42
Age		
18–29 years	14 [28]	72
30–39 years	26 [40]	53
40–49 years	30 [42]	56
50–64 years	42 [47]	58
65 and older	38 [52]	59
Union Status		
Yes, any	24 [30]	60
No	34 [47]	59

*Do you think that the pension benefits that most state and local government workers in California currently receive at retirement are too generous, about right, or not generous enough?

**I am going to read some proposals to change the benefits paid to newly hired state and local government workers at retirement. For each, please tell me whether you favor or oppose this proposal: Set an upper limit on the total amount that a newly hired government worker can receive in pension benefits at retirement. Do you favor or oppose this proposal?

***Numbers in brackets are from the 2011 poll (conducted February 28–March 14, 2011); other numbers are from the 2009 poll (con-ducted September 18–October 6, 2009).

Source: The California Field Poll makes special tabulations available through the *Sacramento Bee*. The 2011 results are at http://media. sacbee.commedia/2011/03/16/14/316tabs.source.prod_affiliate.4.pdf. The 2009 special tabulation results, dated October 16, 2009, are no longer online. Less extensive results for both dates directly from Field are at http://field.com/fieldpollonline/subscribers/Rls2369.pdf and http://field.com/field pollonline/subscribers/Rls2318.pdf.

As in the case of pension reforms aimed at unfunded liabilities, immediate budget savings are limited when the policy change focuses on new hires. However, the Brown plan involved a requirement that *current* employees contribute to their pension programs on a 50/50 basis. In most California plans, the employee share of contributions is below 50%—sometimes well below. For example, CalPERS reports an average

one-third/two-thirds ratio for the employee versus employer share. The issue of pensions and the budget will be discussed again after a review of budget accounting.

Budget Accounting

It may seem odd to devote space to budget accounting methodology. In a sense, a public budget's condition is what it is, regardless of the accounting. However, accounting methodology is used by policy makers to judge budgetary health, or lack thereof, and to determine remedies for perceived fiscal problems. California is not unique in its budgetary accounting, but its experience indicates that the way the budget is depicted pushes policy in particular directions. Generally, a legislator told that his or her jurisdiction is running a surplus will think that there is no problem to fix. Alternatively, if the situation is described as a deficit, the reverse will be perceived.

Two important features of state and local accounting are not widely understood. The first is that terms such as *surplus* and *deficit* do not—or need not—mean what they do at the federal level. The second is that although state and local accounting is subject to rules promulgated by the Governmental Accounting Standards Board (GASB), those standards do not apply to the budgets legislators see and approve. Instead they apply to the information provided to potential investors in prospectuses when securities are issued. Given the second point, as sovereign entities, state and local governments are free to use whatever accounting they like for their own internal planning and legislative purposes.

To understand the problem, note that at the state and local levels there are typically various funds kept separately and treated in a way that loosely corresponds to a household checking account. The common practice is to have a general fund that covers the ongoing operations of the jurisdiction. Usually when terms such as *surplus* or *deficit* are applied, they refer just to the general fund. But there are also special funds for particular purposes. For example, as is the case in California, the gasoline tax and certain other motor vehicle–related taxes and fees go into a special fund for transportation expenses such as road maintenance and construction. But, again as in California, there can be hundreds of other funds, some quite small, earmarked for particular purposes.

Special funds often do not have a clear time dimension. For example, constructing a road may take several years. A public authority will approve the project and then expend funds as needed. Revenues will arrive to fund the project or, particularly for a capital project, there may be borrowing to support it. The controlling authority needs to be sure that, whether from a net revenue inflow or from borrowed money, there is a

sufficient reserve to pay ongoing bills. In short, the key indicator for the controlling authority to watch is the reserve—a stock measure. Like a household managing its checkbook, the controlling authority must avoid overdrawing its account (having a negative reserve).

The general fund, because it finances ongoing expenses, is typically enacted on a fiscal year basis (although some jurisdictions use two years as the relevant period). Most of what flows into the general fund is tax and fee revenue for that year. Most of what flows out is the ongoing expenses for the year such as salaries of teachers, police, and other public employees; transfer payments to individuals (welfare); payments to providers with whom the jurisdiction contracts; and transfers to lower levels of government.

There are three components of the budget process: two flow measures (the inflows and outflows) and one stock measure (the reserve) to be forecast and budgeted. The projected reserve in the fund at the end of the fiscal year is determined by the reserve at the start of the year plus the *net* inflow (which can be positive or negative). There is a mix, therefore, of flow and stock measures that gives rise to a confusion in terminology, which then affects fiscal policy.

At the federal level, there is no reserve. When the federal deficit (or surplus—there have been some!) is discussed, the concept is unambiguously a flow concept. A deficit means less is flowing in than is flowing out. A surplus is the reverse. At the state and local levels, however, and particularly in California, the flow and stock distinction tends to be lost. A situation in which inflows are less than outflows might be referred to as a surplus or balanced as long as the reserve remains positive. (The reserve will be falling in such a situation but may not be less than zero at the end of the period.) Similarly, if inflows exceed outflows but the reserve is projected to be negative at the end of the period, the budget might be described as in deficit or unbalanced. (If the reserve is negative at the beginning of the period and inflows exceed outflow, it will be less negative but not necessarily positive at the end of the period.)

The flow–stock confusion at the state and local levels can affect policy. For example, in the 2000–2001 fiscal year, California had a significant reserve that had built up during the dot-com boom. But the economy was turning down, and the state was running a small deficit in the federal sense (outflow greater than inflow). At the time, however, state officials were insisting that they would deal with the consequences of a disastrous electricity deregulation plan by spending money from the perceived surplus on electricity. A colleague and I warned in an editorial that if California ran a deficit at the peak of the cycle, it would likely face a budget crisis as the economy worsened.[26] Then-Governor Davis's finance director replied

that there was no problem and that we were in error—the state was actually in surplus. What he meant was that there was still a positive reserve. The ultimate consequence of this confusion was the predicted budget crisis and, ultimately, the recall of the governor.

Similar confusion has characterized the periods leading up to and in the aftermath of the Great Recession. Even before the Great Recession officially began, California was running a deficit in the federal sense, but the budget was described as balanced until the inevitable budget crisis occurred. Attempts to remedy the crisis have also been colored by accounting methodology. Once the reserve was negative, any budget that did not lead to a projected positive reserve at the end of the fiscal year was described as a deficit or unbalanced. That approach effectively means that fiscal policy must aim at correcting the negative reserve within a fiscal year period; it rules out the possibility of an alternative policy to consider a multi-year workout plan.

Apart from its influence on fiscal policy, the stock–flow confusion at the state and local level may be part of the story behind the lag in public employment response to economic downturns. The confusion during the downturn tends to mask the fiscal problem since the terminology can indicate budgets are in balance until the last penny of the reserve is gone. That impression delays the urgency of a response until there is a full-blown crisis when the reserve goes negative and cash flow problems begin to be felt. When there is a crisis, the stock–flow confusion suggests that there must be a very fast resolution of the crisis—which can lead to layoffs even in the face of steady budgetary improvements. If a budget already is in a negative reserve position, the description of it as being in deficit even when there is a surplus in the federal sense of the word takes the option of a multi-year solution off the table.

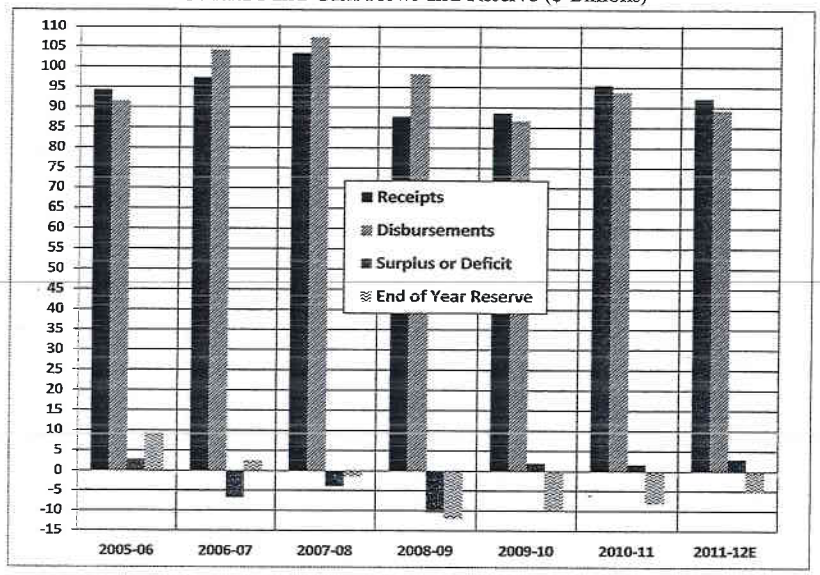
Finally, note that the call for legally binding rainy day funds is partly a by-product of current state and local accounting practices. Efforts to create such rainy day funds have been a feature of California state politics over the years, particularly during the governorship of Arnold Schwarzenegger (2003–2011). In effect, the formulas proposed for rainy day funds divert some of the inflow that otherwise would fatten the reserve during good times into a separate pot. They seek to avert legislators' eyes from the growing reserve. Assuming a separate rainy day reserve is built, flow from the rainy day reserve into the regular reserve during hard times might allow a multi-year workout for a fiscal problem rather than a one-year resolution. But the formula budget or rainy day approach might not be needed if state and local governments carefully distinguished stocks from flows.

California's Fiscal Adjustment to the Great Recession

Figure 10 depicts the cash flows into and out of the California general fund and the reserve in the fund. Except for fiscal year 2011–2012, the data are actual results after the fact.[27] The data for fiscal 2011–2012 are the official estimates for the budget enacted in June 2011.[28] After-the-fact data do not reflect the original budget proposals, which are made by the governor in early January before the start of the fiscal year. The original budget proposal is typically modified in May by the governor—the "May revise"—to reflect updated figures on revenues and spending as well as political feasibility. Once a budget is enacted, however, what happens after the fact may not be what was planned. In short, Figure 10 omits the *Sturm und Drang* that ultimately led to the actual results. But it does provide some insight into the degree of fiscal adaptation to the Great Recession and its aftermath.

Some key points can be seen on the chart. First, California found itself in deficit as early as the 2006–2007 fiscal year (i.e., *before* the Great Recession). That fact is a reflection of the underlying problem of a structural deficit—a deficit that is not corrected by good economic times, which, as noted earlier, developed in California in the early 1990s. Second,

FIGURE 10
General Fund Cash Flows and Reserve ($ Billions)



E = Estimate
Source: California State Controller; California Department of Finance. See endnotes 27 and 28.

the positive reserve in the general fund shown on the chart in the earlier years was present only because incoming Governor Schwarzenegger borrowed his way out of the budget crisis left by his predecessor. So, even at the business cycle peak with an ostensibly positive reserve, the state was living off borrowed funds.

Third, the state did make a major fiscal correction in response to the Great Recession. Revenue fell very sharply during fiscal year 2008–2009, producing a large deficit. But by the following year and in the year after that, the state ran budget surpluses on a cash flow basis, thanks to temporary tax increases and spending cuts. There were budget tricks of various types in that period, but these measures worked well enough. There was a cash flow crisis in summer 2009, which led to the state issuing IOUs for some expenses and for tax refunds, but those IOUs were paid off within a few months.

Fourth, the budget projection for fiscal year 2011–2012 shows a drop in revenue because the temporary tax increases enacted during the 2008–2009 fiscal year expired. Even so, the state planned to run a budget surplus. Because the governor would do the accounting, the fiscal objective, driven by the budget accounting methodology described in the previous section, was to end with a positive reserve. On a projected cash basis, however, the reserve will not end in positive territory at the close of fiscal 2011–2012, despite what would then be three years of budget surpluses.

Fiscal and Labor Adjustments

Officially, the Great Recession began in late 2007. Its downward pace was greatly accelerated by the financial crisis in mid-to-late 2008. Thus, much of the budgetary impact was felt during the governorship of Republican Arnold Schwarzenegger, who took office in October 2003 in a recall election, was re-elected in 2006, and left office in January 2011, succeeded by Democrat Jerry Brown. Schwarzenegger's success in the 2003 recall was largely the result of his predecessor's budget crisis. What Schwarzenegger inherited from his predecessor, Democrat Gray Davis, was a fiscal workout plan.

By the time of the recall, the United States and California economies had been recovering, and the state budget situation was improving. But there was a large overhang in the form of a big negative reserve in the general fund. This overhang was being financed by short-term borrowing from external and internal markets. Internal borrowing essentially means that the general fund borrows from other state funds. To the extent that the internal option is exhausted and external borrowing is needed, the state becomes subject to financial market forces.

At the end of fiscal year 2003–2004—which would have been Governor Davis's responsibility had it not been for the recall, the state would have needed to roll over its short-term external debt. It could have done so but only at increasingly punitive interest rates. Therefore, Davis had developed a complicated plan to refinance on a long-term basis. The complication was the state's constitution, which requires a vote of the people for issuance of long-term debt and bans long-term borrowing to fund ongoing operating expenses. Long-term borrowing is seen as appropriate for long-term capital projects as long as the electorate approves.

To get around the constitution's two hurdles, Davis proposed an elaborate scheme known as the triple flip, whose details are unimportant. What is important is that any attempt to avoid constitutional strictures was bound to be legally questionable, and taxpayer lawsuits were a certainty. Thus, although there was a Davis plan for long-term refinance—essentially a multi-year workout approach—it is doubtful that the bonds underlying that plan could have been sold. Investors would have had to take the risk that a court decision would declare the bond flotation unconstitutional, potentially making their bonds worthless.

A New Governor and a Year of Good Feeling

Incoming Governor Schwarzenegger inherited the Davis plan but capitalized on his initial popularity to enlarge the Davis plan (raising the proposed borrowing from about $10 billion to $15 billion) and to legalize it by taking it to the electorate in a special election. Two related propositions (Propositions 57 and 58) were approved by voters in 2004, which modified the state constitution. They allowed long-term financing for ongoing operations on a one-time basis and added loose provisions for dealing with future budgetary emergencies.

The legislature had approved placing the two propositions on the ballot as part of a bipartisan compromise on their terms. Then the governor and most of the other state officials (Democrats) sold the plan as a one-shot remedy after which the state would supposedly "throw away the credit card." Public sector unions that might otherwise have faced member layoffs endorsed the plan. Thus, calendar year 2004 was an era of good feeling with high popularity ratings for the governor. The budget crisis seemed to end, and the public was treated to a bipartisan deal.

Labor Confrontation

The era of good feeling came to a screeching halt in 2005, dubbed the "Year of Reform" by the new governor.[29] Governor Schwarzenegger harbored the notion that the main problem in state politics was the influence of special interests, a view much in line with California's historic

furloughs on state workers. There was litigation over whether such furloughs could be ordered for the staffs of other elected officials, such as the state controller and the treasurer, or in programs not funded by the state. That issue was not finally decided by the courts until after Governor Schwarzenegger left office. (It was decided in favor of the governor.)

What finally emerged in February 2009, after a few necessary Republican legislative votes were negotiated, was a set of temporary tax increases. These increases were to expire in 2011, but the February deal put further extensions of the increases beyond 2011 on the ballot in a special election scheduled for May 2009. Other propositions placed on that ballot were to facilitate borrowing against the state lottery and diversion of taxes earmarked for child welfare and mental health to the general fund.

The February 2009 deal had several effects that went beyond the immediate budget concerns. Included among the tax extension propositions was a state spending cap determined by a formula—something Republicans generally have supported and Democrats have not. Also included was an agreement to put a proposition on the ballot to change the primary system so that legislative candidates would run in top-two nonpartisan primaries.[33] Proponents argued that such a system would favor more centrist candidates who would be less likely to produce stalemates over budgetary and other matters.

As a consequence of the February 2009 deal, the few Republicans who went along with the accord were punished. The Republican legislative leaders in both houses lost their positions, decreasing the chance of any future bipartisan accord in future budget negotiations. The top-two primary system was eventually approved by voters, thus changing the electoral system. As the May 2009 special election on extending the temporary tax increases approached, the labor movement was split. On one hand, there was a chance for more state revenue. On the other hand, there was the disliked spending cap. As a result of the split, the pro-extension campaign was offset by a strong opposition effort, and the tax extensions failed. Given the rejection of the extensions, the outcome of the May 2009 election set calendar year 2011—when a new governor would take office—as a likely year for strife over the state budget.

IOU Season, the Post-May 2009 Budget Crisis, and Arnold's Last Stand

More immediately, however, the voter rejection of the substantive propositions in May 2009 was taken by Governor Schwarzenegger as a sign that the electorate would support deep cuts in the budget.[34] He produced a new budget proposal that included such drastic measures as an end to the Healthy Families program (health insurance for children of the working poor). Not surprisingly, the result was a stalemate in the legislature and the issuance of IOUs by the state for certain tax refunds and vendor payments during summer 2009.

Technically, however, there was a budget in place as a result of the February 2009 multi-year deal, so the earlier question of paying state workers only the minimum wage, absent a budget, did not come up in summer 2009. Eventually, a budget revision was enacted with more cuts and layoffs. The governor imposed further cuts via line item vetoes that were challenged in court unsuccessfully.[35] And the stage was set for yet another budget battle when the governor, leaving office in January 2011, issued his budget proposal for fiscal year 2010–2011.

The 2010–2011 budget process took place with a gubernatorial election in the background and a continuing budget crisis. Governor Schwarzenegger, a lame-duck governor increasingly disliked by members of his own party, sought to curry favor with the Obama administration from time to time, hoping for fiscal aid from Washington. But beyond the general stimulus funding that went to all states, special assistance to California never came. At the end of his second term, Governor Schwarzenegger left office in a position similar to his predecessor Gray Davis, who had been pushed out in the 2003 recall: Schwarzenegger was equally unpopular and left a legacy of accumulated debt.[36]

As has been noted earlier, the 2009–2010 and 2010–2011 budgets were in official surplus, but past debt and the problem of temporary taxes slated to expire in 2011 needed to be resolved. Thus, Schwarzenegger and his successor needed large budget surpluses—bigger than those actually achieved—to undo the legacy. And any quick resolution of the debt legacy was made difficult by a sluggish recovery in the aftermath of the housing bust which, like the earlier dot-com bust, disproportionately affected the state's economy.

Not surprisingly, when July 1, 2010, came, there was no state budget enacted or even in sight. The upshot was more furloughs and a resurrection of the minimum wage issue. By that time, the state controller had only one path of resistance against the governor's order to pay state workers the minimum wage. Litigation in prior episodes had left open only the argument that state computers were unable to make the change in a manner consistent with labor law. Even though no budget was enacted until October 2010, that tactic proved successful in stalling any actual minimum wage payments.

The minimum wage demand of the governor was mainly a device to push state unions to pressure the Democratic majority in the legislature and to obtain concessions from those unions. Although the savings tended to be less than advertised, unions that signed concessionary deals with

the governor could ask for contractual terms that shielded them from future minimum wage payment threats.[37] And they did.

Voters Sample Whitman but Go for Brown

Until shortly before the November 2010 gubernatorial election, unions faced a significant risk that the new governor would be Republican Meg Whitman, a former eBay CEO who was willing to expend vast sums of her personal fortune on the campaign. Whitman called for an end to defined benefit pensions except for public safety workers. Generally, she made it clear that she would be tough on public sector unions.

Most unions, with the exception of some in public safety (given Whitman's pension exception), backed Democrat Jerry Brown even though he was slow to declare his candidacy officially.[38] Brown was vague about what he might do on pensions. He had been governor in the late 1970s and early 1980s and was famously mercurial in that era—and not always perceived as a friend to labor. Despite his slow start in the 2010 campaign and Whitman's supersized campaign spending, Brown had the advantage of a Democratic-leaning state and voter disenchantment with the idea that an outsider such as Whitman could solve the state's fiscal problems.

Now unpopular, Schwarzenegger had portrayed himself as an outsider in the 2003 recall, and the Democrats played up the similarities of Schwarzenegger and Whitman. As a result, Whitman distanced herself from Schwarzenegger to the point that he never endorsed her candidacy. Whitman also had to take stands, particularly on immigration, to appeal to the Republican right in the June primary, and her attempts to backtrack in the general election angered her base.

Nonetheless, opinion polls put Brown and Whitman in a virtual tie in September 2010. What seemed to turn the electorate against Whitman was the "Housekeeper-Gate" scandal. Whitman had employed a maid who turned out to be an illegal immigrant. She fired the woman, allegedly made the kind of remarks a billionaire should not make to a low-paid housekeeper, and was sued for back wages. In a TV interview, Whitman said that her former maid should be deported. The spectacle of a billionaire mistreating the help turned the polls against Whitman, and she lost badly given the money she had spent on the campaign: 54% to 41% (with the balance of votes going to minor party candidates). Indeed, Whitman received fewer votes than a proposition also on the November 2010 ballot to legalize marijuana (which also lost).[39]

There were other ballot propositions in November 2010 that were to have an impact on subsequent budgetary developments. Proposition 21 would have provided for an added motor vehicle fee of $18 per annum earmarked for state parks, some of which were threatened with closure.

California motorists would have been able to enter the parks for free had it passed. But it failed, and the result was taken as a sign that voters were not receptive to tax increases.

Proposition 22 was designed to restrict the state from raiding local government funding. Among the seemingly protected local entities were community redevelopment agencies. Such agencies rely on tax increment financing and other sources for local construction and infrastructure projects. This proposition passed but proved to have an unintended consequence, discussed later.

Proposition 25 also passed. It changed a Great Depression era requirement that state budgets had to be passed by a two-thirds' majority. Henceforth, the requirement would be only a simple majority. However, the requirement that tax increases could be enacted only by a two-thirds' legislative vote remained. Indeed, voters enacted Proposition 26, which tightened the tax versus fee distinction to prevent the legislature from relabeling taxes as fees in order to escape the two-thirds rule.

Proposition 25 contained a kicker to enhance its appeal to voters that would play a role in the drama of enacting a budget for 2011–2012. The legislature could pass a budget by majority vote as long as there were no tax increases, and it was "balanced" by some definition. But if they failed to pass a balanced budget, there was also a punishment. Legislators would lose a day's pay for each day beyond June 15, the constitutional deadline, that they failed to pass a budget.

How Now Brown?

As a gubernatorial candidate, Jerry Brown never said he wouldn't raise taxes.[40] But his campaign was based on a pledge that there would be no new taxes (or implicitly no extension of the expiring temporary tax increases) without a vote of the people. When he took office in January 2011 and presented his budget proposal for fiscal year 2011–2012, Brown did propose extending the expiring temporary taxes via a vote of the people. However, there were only two routes to such a vote. The legislature could put the tax extensions on the ballot or it could be done by initiative. Either way, it seemed important, at least initially, for the vote to occur before June 30, 2011. After that date, the tax extensions would become tax increases—and polling suggested these would be less likely to be approved.

Forgoing the Initiative Option

If it could be accomplished, the legislative route would avoid the cost of gathering signatures but would require a two-thirds' majority vote, which meant a few Republicans would have to go along. If a few Republicans

could be persuaded to cooperate, Brown would have the advantage of billing his proposal as bipartisan. But that seeming advantage was questionable. At most, Brown might have obtained a few Republicans who would support having a vote but who would themselves urge voting no.

Either the legislative or initiative route would have to be completed in about three months to allow time for the administrative process to arrange a special election before June 30, 2011. Brown could have tried both routes simultaneously so that at least one might succeed. But he made a fateful decision to go only the legislative route despite Republican indications that either no deal was possible or would involve terms on a host of issues that Brown could not accept.

Forgoing a Budget from Hell

Brown could have provided two budgets: one assuming success in having a vote of the people on tax extensions and the other assuming a "budget from Hell" if the extensions were rejected. But there were fears that if a "budget from Hell" were made public, Democrats and public sector unions might defect and/or voters might feel the governor was threatening them. So Brown presented only a budget based on winning tax extensions and painted only a loose verbal picture of what an alternate "budget from Hell" might entail.

Forgoing a Multi-Year Approach

The final major choice Brown made was that he would define a deficit as anything that did not produce a positive reserve by June 30, 2012. As noted earlier, this common state and local fiscal approach means that even a surplus budget in the common English usage of that term (inflow greater than outflow) can be termed a deficit if it is not a big enough surplus to end with a positive reserve. As noted, this definition effectively takes a multi-year solution option off the table, although such an option might at least be considered. The Legislative Analyst's Office did point to the multi-year option and even provided some guidance as to how the approach might be undertaken.[41] But the governor did not go that route.

Realignment

Given his projected revenue needs, even assuming the tax extensions, Governor Brown looked for all sources he could find. One element of the budget was realignment, for instance, which meant pushing certain responsibilities to local government. The most controversial element was moving state prisoners guilty of certain nonviolent offenses to county-operated jails. Apart from dealing with the litigation on prison overcrowding that was forcing the issue, realignment had the benefit of making the state budget smaller and thus reducing funding guarantees to K–14 education under Proposition 98. Realignment was rationalized, however, on the basis of the benefits of local control and discretion. Helping realignment's prospect was the general weakening of the influence of the prison guards' union.

Picking a Fight over Redevelopment

Proposition 22, passed in 2010, made raiding local governments for revenue more difficult. In particular, it was harder to pull funds away from local community redevelopment agencies. So what Brown proposed was to abolish such agencies totally; the notion was that if they did not exist, the state could take their funds. The abolition was justified on the grounds that the job creation attributed to the agencies was dubious. However, local municipalities that had created such agencies did not see the issue that way nor did building trades unions. An eventual compromise was reached whereby the agencies could stay in operation as long as they paid the state for the privilege. The agencies took the issue, however, to the state supreme court.[42]

Dropping the Timetable

Brown appeared to believe that the Republicans would ultimately compromise and allow at least a vote on tax extensions by the end of June, but they did not. He did not have a budget enacted within his original time frame nor within any time frame that would allow a vote on tax extensions by June. That development meant he had to follow standard practice and produce a second modified budget proposal, the May revise.

He also had to either abandon the tax extensions or try to negotiate for enough Republican votes to put them on the ballot sometime after June. By that point, however, the extensions would be increases and unlikely to pass.[43] Nonetheless, Brown continued to negotiate with legislative Republicans into June, while giving continued assurances to Democrats that he could reach a deal. Brown did produce a May revise, and legislative leaders eventually pushed through a majority vote budget with no tax increases or extensions. But the story did not end with that vote.

Two Heroes

As the June 15 constitutional deadline approached, the Democratic majority in the legislature seemed to panic. Governor Brown's dealings with legislative Republicans seemed to be going nowhere. The Democrats quickly put together a budget that could be passed in time to avoid losing pay under the stricture of Proposition 25. In theory, the legislature could put together a budget that ostensibly was balanced by simply assuming sufficient revenue and including unspecified cuts. However, even a fanciful budget has to comply with the formula rules.

Although no complete package had ever been vetoed, Brown almost immediately vetoed the entire budget package, producing a drama that made him a media hero. Legislative leaders were miffed but noted that because they had passed a budget by June 15, their pay should not be cut under Proposition 25. They had complied with Proposition 25 even if the budget was not in effect due to the veto. At that point, state controller John Chiang stepped forward.

The controller declared that the legislature had not really passed a budget because, in his analysis, the legislators had in their haste not properly complied with required formulas and other technical elements. What he was saying was that to count as a true budget enacted by June 15, the plan had to be correct and that, in this case, the legislature had not done its sums correctly. There would be no pay until a correctly done budget was passed (even if it were fanciful). Chiang emerged as a second media hero for denying the legislators their daily bread. The fact that, in his analysis, any fanciful budget with the sums done correctly would pass muster was lost in the general celebratory atmosphere.

Final Enactment

On June 27, 2011, a deal was announced between Democratic legislative leaders and the governor. There would be an all-cuts budget that could be passed by majority vote. It would assume $4 billion in unspecified revenues beyond prior projections. In the past, there had been budgets that relied on forecasts of revenue that seemed dubious, but the supposed revenue was always allocated among the various taxes the state collects. In this case, however, the revenue was just an add-on above the regular projections and not added through any specific taxes.

In effect, the legislature was saying that it expected extra revenue to appear although it could not say from what source. However, the enacted budget provided a trigger mechanism that would mechanically cut the budget should total revenues fall short of assumptions by various amounts. Brown signed the budget, incorporating some line item vetoes, and Controller Chiang deemed it to be a real budget. The controller's decision thus made legislators eligible to be paid (although not for the interim between June 15 and passage of the second budget).[44]

The new budget was enacted in time to avoid any crises that might result from having no budget in place. But there were loose ends. Litigation continued under Proposition 22 over the compromise redevelopment plan that allowed community redevelopment agencies to operate if they agreed to pay the state for the privilege. The outcome of realignment as applied to state prisoners remained unclear. There was no certainty about revenues, including the added-on $4 billion. And whether the trigger would be pulled if revenues fell sufficiently short of projections was also unclear. What the legislature enacted in June—including the trigger—it could revise any time thereafter.

As Figure 10 indicates, on a cash basis, that the budget enacted for 2011–2012 would still leave the reserve in negative territory at the end of the fiscal year, even though receipts would exceed expenditures—that is, the budget would be in sufficient surplus to reduce the negative reserve but not to end it. On the accrual basis used by the governor, the reserve would end up positive but only by a little more than a billion dollars, a razor-thin amount in a budget of more than $88 billion. And if the $4 billion failed to appear and if the trigger were pulled, there could still be a negative reserve at the end of the year, depending on expenditures.

The Pension–Budget Link

In the months following budget enactment, the governor hinted that he would be making proposals to modify state and local public pensions. Indeed, some of his failed budget negotiations with legislative Republicans involved the pension issue. As noted earlier, Brown eventually did produce the outlines of a pension proposal in late October 2011 involving increased employee contributions for active workers and a two-tier hybrid approach for new hires that included a mix of defined benefit and defined contribution.[45]

Brown indicated he wanted a ballot proposition to approve his pension plan—presumably a proposition put on the ballot by the legislature. It is possible at this writing, however, that there could be competing propositions placed on the ballot by initiative, and it is likely that the pension proposals will become intertwined with negotiations over the budget for 2012–2013. Public sector unions might go along with some modified version of the Brown pension proposal, but only if they were to find the threat of alternatives to be an even less desirable outcome.[46] In contrast to the tax issue, which was so prominent in the 2011–2012 budget negotiations, some Republicans might go along with Brown on pensions. But he would still need a mix of Republican and Democratic votes to use the legislature as the route to the ballot. Brown could take the initiative route but would need funding for gathering signatures—and presumably not much funding would come from unions to take that route.

Conclusions

In a sense, there is no conclusion to California's fiscal drama. Year after year, new budgets must be enacted. Economic and political developments from outside the state have tended to be the ultimate driver of state fiscal

affairs. At this writing, there is much uncertainty about the larger economic and political outlook. But there do seem to be some lessons from the California experience.

California's processes of direct democracy—as well as other institutional features of its internal polity—are clearly part of the mix of influences on the state's fiscal and labor responses to the Great Recession. Voters have enacted some reforms related to redistricting and to the format of primaries intended to lessen legislative partisanship and polarization. Various groups are touting other ballot initiatives to reform state government. Nonetheless, California has been operating with a structural budget problem going back to its insufficient adjustment to the impact of the end of the Cold War on federal military-related spending in the state.

The large geographic size of the state means that it is actually composed of regional economies. Thus, the decline in aerospace after the end of the Cold War was concentrated in Southern California. The dot-com boom and bust was largely a Bay Area phenomenon. Because much tax revenue is collected statewide and local government budgets are intertwined with the state budget, however, problems in one region are transmitted to others via the public sector.

The public sector response operates with a lag due to the ability of governments to pull down reserves and to borrow in various forms. In the Great Recession's aftermath, the lag was lengthened by the availability of federal stimulus funding, albeit with various limitations on that funding on state and local fiscal uses. Despite appeals for special assistance, Washington was reluctant to do any particular favors for California beyond the general aid available to all states.

Although public sector workers in California have the right to strike and collective bargaining is more prominent in California's public sector than in the average state, the strike weapon was not seen as effective by unions in most jurisdictions, given the impact of the Great Recession. Unions tended to use the political route to exercise whatever influence they could develop.

There were no serious moves to end collective bargaining in California along the lines found in Wisconsin and some other states. However, a proxy battle—yet to be resolved—was fought over the public pension issue. Early skirmishes over the pension issue tended to result in a two-tier approach of decreased benefits for new hires and increased employee contributions to pension funds. It is likely that the pension issue will heat up in 2012 with possible competing ballot propositions. There have already been some ballot skirmishes at the local level on pensions, and more seem to be on the way.

Despite seemingly unique features, California ultimately mirrors the national debate over the size and purpose of the public sector. At the national level, the Great Recession heightened tensions surrounding that grand debate. What emerges in California is likely to be more a reflection of the larger national conflict than that of strictly intrastate trends and developments.

Endnotes

[1] There have been more nuanced views since of the railroad and its impact on California's economic growth (Orsi 2007). Even as it squeezed local businesses through freight tariffs, the railroad's ultimate interest was a healthy state economy. The Big 4 were Leland Stanford, Mark Hopkins, Charles Crocker, and Collis Huntington, whose names remain on various contemporary San Francisco Bay Area institutions and locations (Rayner 2008).

[2] Republican governors—from Deukmejian in the 1980s to Wilson in the 1990s to Schwarzenegger in the 2000s—have long sought to take redistricting out of the hands of the Democratic-dominated legislature. When Republicans finally succeeded through a ballot proposition in winning such a procedure for the post-2010 U.S. Census redistricting, they subsequently became the procedure's most vociferous critics and filed referenda and litigation to overturn the outcome. The nonlegislative tribunal set up to do the redistricting, which consisted of citizens selected through a complex process, produced district maps that appeared to weaken Republican influence. The challenges were mounted against the state senate and congressional proposed districts. State assembly districts were not (at this writing) challenged.

[3] The California freeway system, established in 1947 under Governor Earl Warren, featured an earmarked gasoline tax and trust fund, the model later followed at the federal level (Mitchell 2006a).

[4] Kevin Starr (2009) describes the development of California in the post–World War II period.

[5] Proposition 13 was the result of a confluence of forces. There was a busing controversy in Los Angeles. Busing tended to disconnect white home owners in the San Fernando Valley, where much of the Proposition 13 agitation developed, from neighborhood schools—and schools and property taxes were linked. In addition, a series of court decisions had pushed for equalization of school finance across school districts. Thus, increased property taxes did not necessarily go to local schools because the state effectively rechanneled revenue to equalize per student funding.

[6] On the post-1990 period, see Starr (2004).

[7] Unionization data are from http://www.unionstats.com.

[8] A summary of California law regulating collective bargaining in the public sector can be found in Edelman and Mitchell (2004).

[9] The 2006 county stoppages took place in Santa Cruz, Sacramento, and Contra Costa (in addition to the City of Los Angeles stoppage mentioned in the text). The 2007 stoppages were in the transit district covering Orange County and the Hayward school district. Finally, the 2010 stoppages occurred in the Capistrano and Oakland school districts (http://www.bls.gov/wsp/#news).

[10] At the time, Governor Reagan was a potential candidate for the 1976 Republican presidential nomination, a goal he failed to achieve in 1976 but succeeded in attaining in 1980. Proposition 1, had it passed, would have been a political asset for Reagan in his 1976 effort (Mitchell 2007).

[11] The Gann limit was much simpler and less restrictive than Governor Reagan's Proposition 1.

[12] It appears that even the gutted Gann limit was actually reached at the peak of the tax revenues from the dot-com boom. But estimates of revenue at the time fell under the limit, so no action was taken.

[13] The files were downloaded from the U.S. Department of Labor website in August 2011. They are available online at http://www.dol.gov/olms/regs/compliance/cba/index. htm. Because the files refer only to contracts covering 1,000 or more workers, they may understate the importance of unions representing smaller units.

[14] For discussion, see Mitchell (2008b). Union officials sometimes explain the aversion to the ballot initiative approach by citing the costs involved compared to more traditional legislative lobbying.

[15] Paycheck protection measures require unions to obtain support from individual members before using dues money for political purposes. The 2005 version applied only to public sector unions, although it was unclear whether it would have affected union members in the private sector who also represented public workers. The 1998 measure applied to both sectors (Clark 1999). At this writing, it appears there will be another paycheck protection measure on the 2012 ballot.

[16] The spending cap was delayed to a later year.

[17] A union representing hotel workers succeeded in having the Los Angeles city council enact a living wage ordinance for hotels near the Los Angeles airport on the grounds that the hotels—while not providing services to the local government—were economically linked to the municipal airport.

[18] Conservative jurisdictions tended to enact blanket bans on project labor agreements. However, the legislature enacted a ban on enactment of local blanket bans. Thus, while local jurisdictions are not forced to use project labor agreements, they must make the decision on a case-by-case basis.

[19] The Inland Empire is generally considered the area east of Los Angeles, centered in Riverside and San Bernardino Counties.

[20] In Wisconsin, the Republican governor and legislature essentially ended collective bargaining as it had previously been practiced. A similar move occurred in Ohio, but voters reversed it in a referendum in November 2011.

[21] The fact that one Costa Mesa employee committed suicide by jumping off the roof of city hall especially attracted media attention.

[22] Among the San Francisco Democrats who were particularly active in pushing pension cutbacks were former mayor and speaker of the state assembly Willie Brown and public defender Jeff Adachi (a declared candidate for mayor in 2011). Adachi put two measures on the municipal ballot restricting San Francisco pensions. Both lost, the most recent in November 2011. An alternative proposition on pensions in San Francisco—negotiated by the mayor with local unions—was approved by voters in November 2011.

[23] For the study and its methodology, see California Foundation for Fiscal Responsibility (2011).

[24] Journalistic accounts of the poll focused on support for the remedies and not the plurality of respondents who felt that pensions were about right or insufficient (DiCamillo and Field 2011).

[25] The statement was made by Local 1000 president Yvonne Walker (Ortiz 2011).

[26] The budget data cited in the editorial were readily available (at the time) online from the California Department of Finance (Hirsch and Mitchell 2001).

[27] The data for Figure 10 come from the June monthly statements of the California state controller, available at http://www.controller.ca.gov.

[28] The data for budget year 2011–2012 come from the California Department of Finance and are available at http://www.dof.ca.gov/reports_and_periodicals/documents/2011%20BA%20Cash%20Flow%20for%20Web.pdf.

[29] Details of this period are discussed in Mitchell (2006b).

[30] A public pension initiative was supposed to be part of the package but was dropped from the group due to drafting problems.

[31] Details of this episode are described in Mitchell (2008a).

[32] Initially, unions opposed Governor Schwarzenegger's budget plans. But as will be noted later in this chapter, as the budget problem evolved, some unions cooperated with the governor (Mitchell 2009).

[33] In a top-two primary, all candidates of all parties initially run against each other. The top two run against each other in the general election. There is no partisan primary. The top two might thus be from the same party. Such primaries are in wide use in local governments in California. The theory is that in the primary with multiple candidates competing, there will be an incentive to appeal to voters from the minority party in order to put together enough votes to make it into the runoff. In partisan primaries, in contrast, the appeal is only within the party; thus, in Republican or Democratic majority districts, only the majority party has any chance in the general election, and minority party voters are without any influence.

[34] This section is based heavily on Mitchell (2011).

[35] The governor has line item veto powers when a new budget is enacted. Plaintiffs argued unsuccessfully that the budget revision was not a new budget, just a modification of an old one; therefore, the line item power did not apply.

[36] At the end of his term, Governor Schwarzenegger's reputation was tarnished by a prison sentence reduction he gave to the son of a political ally. Shortly after leaving office, a sex scandal within his family further damaged his standing. However, before either of these problems arose, Schwarzenegger's poll ratings in 2010 were virtually tied with those of Davis at the time of the 2003 recall.

[37] Under the standard procedure for state union contracts, the Legislative Analyst's Office issues a report on the contract terms and whatever savings it estimates. Those estimates typically were below the levels that had been announced earlier when the negotiations concluded.

[38] Brown ran unsuccessfully for the U.S. Senate in 1982 and lost to Pete Wilson. He was out of office for a time but came back to elective office as mayor of Oakland and then state attorney general. Thus, his campaign focused on having had long experience in state and local government.

[39] Whitman officially spent $178 million on the campaign, of which $144 million came from her personal fortune (see http://www.followthemoney.org/database/StateGlance/

candidate.phtml?c=116698). Brown spent about $41 million (see http://www.followthemoney.org/database/StateGlance/candidate.phtml?c=116678). It is impossible to track union support for Brown in dollar terms because of independent committees and the passing through of money from one committee to another. However, construction trades were prominent among the unions listed as donors by the official Brown for Governor 2010 committee, as were the various public sector unions such as SEIU and AFSCME (see http://www.electiontrack.com/lookup.php?committee=1321867).

[40] I have reported on Governor Brown's budget during his first year in office in Mitchell (2012).

[41] A multi-year approach is described in a letter to State Senator Mark Leno by the California Legislative Analyst's Office (2011a).

[42] That decision proved to be a fateful mistake for the agencies. The end result of the litigation was their total abolition!

[43] Brown tried unsuccessfully to persuade Republicans to go along with a bridge tax that would extend some of the temporary taxes up to the election, but there were no GOP votes for that proposal.

[44] There was successful litigation challenging the controller's action in withholding pay and suggestions that he had undermined his future political career by angering the legislature. But the lost pay was never recouped.

[45] California Governor (2011). Not all elements of the plan are clear from the official document. A detailed analysis of the plan can be found at California Legislative Analyst's Office (2011b).

[46] As noted earlier, SEIU and other unions did not take an explicit opposing position on the Brown plan for pensions—instead treating it politely in public as a starting point for a discussion. A political consultant for a union-backed group dealing with the public pension issue made it clear that the likely strategy would not be to back the Brown plan as presented. See Maviglio (2011).

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